

MEMO# 26269

June 27, 2012

CFTC Proposes Rules Prohibiting Aggregation of Orders for Minimum Block Sizes and Cap Size Requirements

[26269]

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 20-12
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 25-12
SEC RULES COMMITTEE No. 41-12 RE: CFTC PROPOSES RULES PROHIBITING AGGREGATION OF ORDERS FOR MINIMUM BLOCK SIZES AND CAP SIZE REQUIREMENTS

On June 27, 2012, the Commodity Futures Trading Commission ("CFTC") proposed additional provisions related to block trades in swaps. [1] According to the CFTC, after the agency re-proposed the criteria for determining appropriate minimum block trade sizes, it determined that the aggregation provision and the provision that specified the eligible parties to a block trade were inadvertently omitted from the re-proposal. [2] To address these omissions, the CFTC is issuing this proposal.

Comments on the proposal are due on or before July 27, 2012. The Institute plans to submit comments on the proposal. If you have any specific concerns, please contact Jennifer Choi at jennifer.choi@ici.org or at (202) 326-5876 by July 13.

Aggregation Prohibition and Exceptions

The CFTC proposal would prohibit the aggregation of orders for different trading accounts to satisfy the minimum block size or cap size requirements except for orders aggregated by certain persons. [3] Aggregation would be permissible if done on a designated contract market ("DCM") or swap execution facility ("SEF") by a person who has more than \$25 million in total assets under management and is:

- (1) a commodity trading advisor ("CTA") registered pursuant to Section 4n of the Commodity Exchange Act ("Act") or exempt from such registration under the Act, or a principal thereof, and who has discretionary trading authority or directs client accounts;

- (2) an investment adviser who has discretionary trading authority or directs client accounts and satisfies the criteria of Rule 4.7(a)(2)(v) under the Act; or
- (3) a foreign person who performs a similar role or function as the persons described above in (1) or (2) and is subject as such to foreign regulation.

To satisfy the criteria under Rule 4.7(a)(2)(v), an investment adviser must be registered pursuant to section 203 of the Investment Advisers Act of 1940 or pursuant to the laws of any state, or principal thereof, and (1) has been registered and active as such for two years or (2) provides securities investment advice to securities accounts which, in the aggregate, have total assets in excess of \$5 million deposited at one or more registered securities brokers.

The CFTC seeks comment on the appropriateness of the exceptions to the prohibition of aggregation of orders and whether the exception should be available to other categories of CFTC registrants. Moreover, the CFTC requests comment on whether the criterion that the exception be available only for those persons with more than \$25 million assets under management is appropriate and whether the requirement should include only swap assets or be based per asset class or be different for the five asset classes of swaps.

Eligible Block Trade Parties and Exceptions

The CFTC proposal also would provide that parties to a block trade must qualify as eligible contract participants (“ECPs”). [4] The proposed rule includes an exception by providing that a DCM may allow certain CTAs, investment advisers and foreign persons to transact block trades for customers who are not ECPs if such CTAs, investment advisers and foreign persons have more than \$25 million in total assets under management. The persons eligible for the exception are the same as those proposed to be excepted from the aggregation prohibition.

In addition, the proposal would require that persons transacting block trades on behalf of customers must receive prior written instructions or consent from the customer. The instructions or consent may be provided in a power of attorney or similar document by which the customer provides the person with discretionary trading authority or the authority to direct the trading in its account.

Jennifer S. Choi
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endnotes

[1] Rules Prohibiting the Aggregation of Orders to Satisfy Minimum Block Sizes or Cap Size Requirements, and Establishing Eligibility Requirements for Parties to Block Trades, RIN 3038-AD84, 77 FR 38229 (June 27, 2012), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-15481a.pdf>.

[2] Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 FR 15460 (Mar. 15, 2012), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-5950a.pdf>.

[3] A block trade has a notional or principal amount at or above the appropriate minimum block size and is reported publicly subject to time delay requirements. A cap size is the maximum notional or principal amount of a publicly reportable swap transaction that is publicly disseminated. A transaction that meets the cap size requirement would be eligible to mask the total size of the transaction if it equals or exceeds the applicable cap size.

[4] ECPs include, among others, an investment company subject to regulation under the Investment Company Act of 1940 acting for its own account and an investment adviser subject to regulation under the Investment Advisers Act of 1940 acting as investment manager or fiduciary for certain persons (including a registered fund). See Section 1a(18) of the Act.

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